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UNCLAS SECTION 01 OF 03 MANAMA 000738

SIPDIS

DEPT FOR NEA/ARP AND NEA/RA
DEPT PASS USTR JASON BUNTIN
TREASURY FOR LEILI MOGHTADER

E.O. 12958: N/A
TAGS: EFIN BA
SUBJECT: BAHRAIN INTERNATIONAL BANK (BIB) LIQUIDATION

REF: 03 MANAMA 850

¶1. SUMMARY: A May 4 Asset Realization Protocol (ARP) formally launched the liquidation of Bahrain International Bank (BIB) after nearly three years of post-9/11 creditworthiness problems. While poor bank management and strategy caused the failure, the Bahrain Monetary Agency (BMA) should have acted sooner and more decisively. While BIB is the only bank to collapse recently in Bahrain, it is one of three banks troubled during the past year. Taken together, these have tarnished Bahrain's image as a well-regulated banking center. The BMA is taking steps to enhance its regulation of the sector, which should restore its reputation. END SUMMARY.

BIB GOES UNDER

¶2. Bahrain Monetary Agency (BMA) and investor efforts to resolve the financial standing of bankrupt Bahrain International Bank (BIB) have failed. The BIB was delisted from the Bahrain Stock Exchange, as recommended by the bank's temporary committee to the BMA's Capital Markets Control Directorate, which approved the move. In a move sponsored by the BMA, On May 4 BIB shareholders, lenders, and depositors formally agreed to an Asset Realization Protocol defining the terms of sale to liquidate BIB assets to repay lenders, shareholders, and depositors.

¶3. Bahrain International Bank (BIB) was established in 1982 as an offshore commercial bank with approximately 7,600 shareholders, primarily from the GCC and predominantly from Bahrain and Kuwait. The bank's principal operations included direct corporate investment and real estate development in the United States and Europe, as well as financial advisory services, according to Capital Intelligence (CI) ratings service. CI highlighted the recessionary period in the Gulf during the early to mid-eighties as a factor in the bank's early troubles in developing its commercial banking activities. This served as a rationale for the bank's focus on investment operations run primarily from its subsidiaries in the US and UK. However, subsequent downturns in the bank's investment portfolio, most significantly since 2001, had forced the bank to liquidate its U.S. and European corporate bond portfolios. The move intended to allow BIB to gain temporary liquidity in order to refinance the bank's debt, according to CI.

¶4. BMA Executive Director of Banking Supervision, Dr. Khaled Ateeq, highlighted September 11 and the subsequent risk climate as overriding factors in the bank's downturn. Significant investments in the United States and the subsequent dramatic slide in investment returns hurt the bank's financial standing, he told EconFSN May 9. Although agreeing with the post-2001 trend, BIB term lender Gulf International Bank (GIB) Managing Director for Risk Management Mohannad Farouki stressed to EconFSN on May 18 faults in BIB's broader strategy, which involved investments of short-term liabilities into long-term assets. Farouki noted that BIB's post-2001 high yield investments were hit badly, while the impact on the bank's private equity portfolio was even more severe.

BMA STEPS IN-BUT TO NO AVAIL

¶5. Dr. Ateeq told EconFSN May 9 that the BMA had been aware of BIB's troubles from the outset and notified the bank's board of directors to increase capital in order to reestablish creditworthiness. However, Ateeq added, BIB's board could not raise the necessary capital and therefore did not fulfill the bank's obligations to its investors and depositors. In response to questions of effective financial supervision, Ateeq noted the significant efforts of the BMA over the past two years in seeking to find a recovery formula for the bank to save it from liquidation. Such measures were regarded as the BMA's preferred course of action in order to bolster the capacities of institutions and substantiate the regulator's supportive role in a banking hub. This is in line with BMA Governor Ahmed Al

Khalifa's December 13, 2003 statements in the local press that the failure of financial institutions could impose significant costs on society as well as impact confidence Bahrain's banking system.

¶6. The BMA cooperated with creditors to assist BIB's recovery. The bank was unable to overcome its liquidity problems due to bad management, Ateeq told EconFSN May 9. As a result, negotiated efforts undertaken by the BMA, creditors, depositors, and shareholders determined the corrective actions for the bank and eventually considerations of asset liquidation. In January 2004, an extraordinary general assembly meeting undertaken by the bank's principal shareholders resulted in an agreement to settle the bank's liabilities over the medium term. On May 5, local newspapers reported the agreement reached May 4 to establish an Asset Realization Protocol (ARP) announcing BIB's liquidation.

¶7. The agreement allowed for the establishment of a specialized committee including creditors and officials from the BMA, as well the appointment of an ARP manager. Both entities would be responsible for overseeing the liquidation or sale of BIB's assets. The final agreement, as stipulated under the ARP, called for 85 percent of revenue gained from assets sold to be distributed to depositors and 15 percent to bank creditors. Following the full repayment of depositors, the remainder of the proceeds will go to bank creditors, in accordance with BMA guidelines that give depositors priority, Ateeq told EconFSN May 9. Any proceeds remaining after full repayment to depositors and creditors would be distributed to shareholders. GIB's Farouki suggested to EconFSN May 18 that finding a resolution to the BIB bankruptcy was not an easy matter and essentially a no-win situation for those involved. As a lender to BIB, Farouki did not expect GIB or other term lenders to receive more than 23 cents per dollar of assets sold.

POINTING FINGERS: BANK MANAGEMENT, FINANCE MINISTER AND BMA ALL IMPLICATED IN BANK FAILURE

¶8. On April 14 local newspapers reported on parliamentary inquiries into the BIB affair. Parliamentarians raised questions of the BMA's role leading up to the bank's bankruptcy, possible penalties to banking executives, and questions about whether other banks in the country in the same situation. According to these reports, Minister of Finance and National Economy Abdullah Saif stressed the efforts of the BMA to resolve BIB's liquidity problems and highlighted that BIB's assets only accounted for 0.4 percent of Bahrain's total bank assets. Saif placed the blame on the bank's board members and executives who failed to conform to BMA guidelines and were not qualified to effectively manage BIB. BIB's circumstances were brought up in later inquiries by parliamentarians into financial irregularities relating to the Minister's (mis-)management role as chairman of the national pension fund. Local newspapers on April 21 further accused the Minister of not taking assurances from the BMA regarding fund deposits in the Bahrain Saudi Bank, another bank suspected of financial irregularities.

¶9. Reiterating his position that BIB's chief executive and board members were unfit to assume positions in Bahrain's banks, Ateeq told EconFSN May 9 that shareholders, creditors, and depositors were free to take legal action against BIB banking officials and chief officers. Farouki noted that the BIB collapse could have been avoided if the bank had not risked client money to pursue its investments in the first place. However, Farouki noted to EconFSN May 18 the evident complexities in imposing more direct BMA-issued punishments on BIB and its executives. In the absence of practical punitive solutions, Farouki told EconFSN that he agreed with Ateeq's suggestion that legal cases brought forth by investors, lenders, and depositors would be the most effective course of action.

BAHRAIN'S BANKING IMAGE SUFFERED

¶10. Farouki told EconFSN May 18 that irregularities involving three Bahrain-based banks-Bahrain Saudi Bank (BSB), Bahrain Middle East Bank (BMEB) and BIB--in the course of a year did tarnish the country's banking image. Potential collapse of BSB and BMEB was averted through BMA action. Only the BIB has declared bankruptcy.

BMA INTERVENTION AT BAHRAIN MIDDLE EAST BANK HAVING EFFECT

¶11. The only other bank in Bahrain currently facing difficulties is Bahrain Middle East Bank (BMEB), Ateeq told

EconFSN May 9. By contrast to BIB, BMEB is now in the process of arranging creditors and refinancing to re-establish the bank. Ateeq emphasized that unlike the case of BIB, BEMB has made a commitment to the shareholders and others. As a result of the BMA's regulatory guidance and supervision, the bank is very likely to survive, Ateeq added. GIB's Farouki supported this assertion, stating May 18 that as long as the bank effectively manages its expenses it will be able to recover. However, the Bahrain Middle East Bank case was not as bad as the BIB affair, Farouki told EconFSN.

BMA TAKING ACTION TO IMPROVE REGULATION, BOLSTER IMAGE

¶12. In response, the BMA is taking steps to improve bank regulation. Pursuing initiatives to promote risk awareness in the country's banking industry, the BMA sponsored a risk survey conducted by PriceWaterhouseCoopers to gauge common issues facing the banking industry. The BMA also issued new corporate governance guidelines for banks in the country. The new guidelines define operational and managing supervision criteria for bank executives and board members in order to ensure effective management as well as ensure performance monitoring. In addition the BMA has sought to re-define punitive measures for banks not abiding by BMA regulatory guidelines and mandates, according to March 31 local news articles.

¶13. COMMENT: The BIB experience should serve as a case study in the value of transparency. Through it, the BMA has accepted the principle that ignoring a bank's problem or not taking swift action in accordance with established regulation is counterproductive in the long run. Overlooking this problem for too long meant its resolution was not in the best interest of stakeholders and caused public embarrassment. FTA commitments to greater financial services regulation and transparency combined with this lesson could improve the sector and enable it in time to recover its former luster. END COMMENT.